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INFLATION
AND OUR ECONOMY



A BRIEF DISCUSSION OF THE FINANCIAL SCENE IN NORTH AMERICA BY

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GRAHAM F. TOWERS
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Since his review of the year 1961, after his election as Chairman of the Board of Canada Life, Mr. Graham F. Towers has addressed every Annual Meeting of the Company. His remarks on these occasions have been distinguished by their clarity and accuracy of prediction.

The address that he gave at the 121st Annual Meeting followed in this tradition and his remarks were widely quoted in the news media.

A Director of Canada Life since 1955, Mr. Towers was formerly the first Governor of the Bank of Canada, President of the Industrial Development Bank and Alternate Governor of the International Monetary Fund.

A Director of a number of leading companies, Mr. Towers became a Member of the Economic Council of Canada during the past year.

We commend his comments to you because they deal with financial problems that face all of us today.

"While there have been a number of important, even startling developments in the financial and economic fields of North America in recent years, I consider the most significant one to be the substantial rise in the cost of living during the last two years in both Canada and the United States. I think it is significant for two reasons. First, because it has had a painful effect on the budgets of many millions of families, and second, because it has brought discussion of inflation out of the realm of the academics right into everyone's daily life. No one can truthfully say that this surge in living costs was a completely unforeseen and unexpected development. In Canada for years past the welkin has rung with warnings and exhortations. On the one hand Government has urged business and labour to keep prices and costs down and to increase productivity. On the other, many members of the public have pointed out the inflationary potential of large increases in Government spending at a time of full employment of our resources. Throughout the period, the inflationary results of increases in wages in excess of increases in productivity have been pointed out almost ad nauseam. So far as tangible results are concerned, this verbal barrage seems to have been an exercise in futility, although it may have had some educational effect. I do think that it is slowly coming to be realized that unless Governments give solid evidence of exercising restraint in their demands on our productive resources, there can be no stability in our economic affairs or confidence in the future. It is too early to say whether this public realization will lead to effective action in the near term and sounder Government policies in years to come. However, I do find grounds for hope in this respect in the widespread unpopularity of these increases in living costs, in the turmoil in bond markets, in

high interest rates and in the plight of housing. These unhappy developments may well lead to the problem of inflation being taken much more seriously.

"I think it is correct to say that no country has yet discovered a satisfactory way of maintaining high employment without inflation. This is neither the place nor the time to embark on a description of the many approaches which are being taken or discussed. One can only say that solutions must be found or the goal of continuing high employment cannot be achieved.

"In discussing the thesis that we can and should accept inflation as a means of achieving high rates of output, the Governor of the Bank of Canada in his last annual report expressed the opinion that this option is not really open to us. He said, and I quote, 'It would soon become just as difficult to prevent price rises from exceeding a high target rate as it now is to prevent them from exceeding a low target rate. The same policies of restraint would come to be required. Nothing would be gained in employment or output; the difficult efforts to adjust to inflation would thus have been to no avail and our ability to grow steadily would be continuously threatened by the impairment of our international competitive position'.

"I think it is unfortunate that the thesis, which the Governor rejected, has received support over the years from various respectable sources. The late Professor Sumner Slichter of Harvard preached this doctrine in season and out. The Economic Council of Canada took somewhat the same line in its First Annual Review in 1964. But surely one lesson to be learned from the events of the last few years is that if one puts the seal of public approval

on continuing erosion in the value of money, people will catch on to what is happening and will try to protect themselves in any way they can. They will shy away from fixed interest obligations or demand a much higher reward for accepting them. Continental Europe has had experience along these lines and managed to survive. But I should hate to see the great capital markets of the United States and Canada struck by a similar blight. In thinking of the consequences the current plight of housing comes to mind, not to mention the financing problems of Corporations and all levels of Government.

"Another evil of accepting a certain degree of inflation as inevitable and tolerable is that it tends to make Governments complacent. Why take politically unpopular measures to fight a rise in the general price level if a little inflation is part of the so-called 'trade-off' against unemployment? Eventually, of course, steps have to be taken if only because substantially rising living costs are widely unpopular. But by that time the problem is more difficult to solve and all kinds of disruptions and distortions have occurred. Moreover, one can never in this modern world get back to the level of prices and the cost of living that prevailed in earlier years. So I believe that Governments should and must set their faces against any continuing rises in the general level of prices. They may not be one hundred percent successful. But, if they try hard, they should be able to do a pretty fair job and avoid the quite disastrous effects of destroying public confidence in the value of money. If, on the other hand, Governments accept continuing inflation as inevitable, even to a limited degree — often defined as one and one-half or two percent per annum — they are defeated before they start.

"It is not often that one finds widespread agreement in regard to any problem in the field of Economics. But there is certainly a growing body of informed opinion supporting the view that the demand for capital in Europe and North America during the next decade will be relatively very heavy and may well tend to exceed the volume of savings. Certainly Canada's needs for capital will be formidable. Because of the age distribution of our population, the percentage increase in the civilian labour force over the next ten years will be far greater than in any other industrial country. The same factor of age distribution will result in a large and rapid increase in the number of marriages. These developments call for the investment of vast amounts of capital to provide employment facilities for the labour force and housing for the new families. Surely it is obvious that Governments must do everything within their power to encourage savings on the one hand and to keep their use of public savings to the lowest practicable figure — in plain words — cut out non-essential expenditures, drastically defined. Any other course of action promotes inflation, which is the greatest deterrent to saving that one can imagine. As I said earlier, the evil and disruptive effects of erosion in the value of the dollar and attempts to do more than our resources will permit are now plain to see.

"I imagine that very few people have been able to read in full the report of the Royal Commission on Taxation — the Carter Report — or the many briefs and comments on the Report which have since appeared. Nevertheless, I commend to your attention the submission made to the Minister of Finance by The Canadian Life Insurance Association entitled 'An Economic and Financial

Appraisal of the Report'. In view of the unanimity of opinion concerning a shortage of capital, the almost cavalier attitude of the Commission towards personal savings is at once both surprising and disturbing. But we must realize that the Report is not just a lengthy treatise on taxation but a socio-economic document with many of the value judgements not always stated explicitly. Myself, I find portions of the Report highly consumption-orientated, and with a definite bias against personal savings. What I would have considered as the virtues of personal savings — its stability through the business cycle and serving as the major source of residential financing — are treated as negatives. Additionally, because personal savings are relatively small compared to business savings, the fact that these savings are the major source of external funds for business and government is ignored. But all Government borrowings, to be non-inflationary, must draw upon personal savings, directly or indirectly. In the last decade, while business savings have provided 80% of total business fixed capital, 20% — the margin if you wish — has been provided by the sale of new security issues to the public. While the Report admits that implementation of its recommendations would affect personal savings, and particularly contractual savings, in a very complex way, and in all probability reduce them, this result is regarded with equanimity. I believe that the Association's brief presents good reasons for thinking that the Report has badly underestimated how much its recommendations would reduce the level of savings in Canada and this at a time when our needs for capital are assuming ever greater importance.

"In closing, lest I be labelled a prophet

of doom, let me say that I believe that the North American economy — the nuts and bolts if you wish — is basically sound and exhibiting surprising strength. As a result the prospects for 1968, as measured by most broad economic indicators, are good. Not as robust as in the last five to six years, but still good. But real growth depends on the public's confidence in their currency as a medium of exchange and store of value. While this confidence has been eroded in recent years, I do not believe that it has been destroyed. It can be restored if we will take appropriate action now to reaffirm that stability of the value of the dollar as one of our economic goals is on a par with any other goal."

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